Industry Canada Industrie Canada

Canada

Q2 2013

VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

www.ic.gc.ca/vcmonitor

This publication by the Small Business Branch provides current information about the venture capital industry in Canada. The series will track trends in investment activity, report on topical research and look at key technology clusters where investment is taking place.

Introduction

This issue covers venture capital (VC) investment and fundraising activity in Canada during the second quarter of 2013. It also describes recent government activity in the VC market.

VC Activity Overview

Investment and fundraising

Small decline in year-over-year investments during Q2 2013

Year-over-year VC investment into Canadian companies remained relatively unchanged. During Q2 2013, $485 million was invested into the market, which is a 3 percent decline from the $500 million invested over the same period last year (Table 1). Notably, average deal sizes rose appreciably, coming in at approximately $4.4 million per deal compared to only $3.5 million per deal during Q2 2012. Also of note, VC investment was more evenly distributed across sectors during Q2 2013 compared to the same period last year when nearly 63 percent of deals went to information communication technology companies.

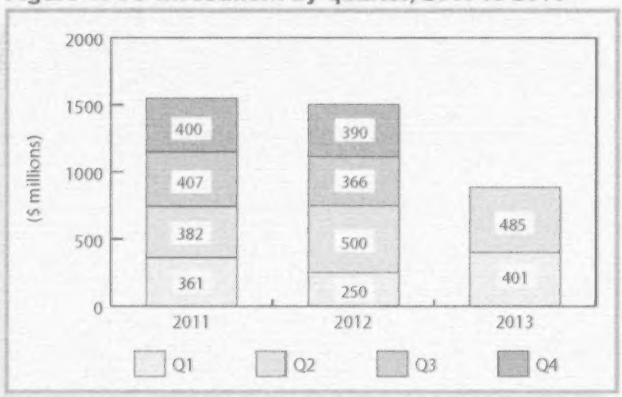
Table 1: VC investment and fundraising, Q2 2012 and Q2 2013

	Q2 2012	Q2 2013	Percent Change
	($ millions)		
Investment	500	485	-3
Fundraising	481	297	-62

Source: Thomson Reuters Canada 2013.

In contrast to investment levels, Canadian VC fundraising activity fell for the fourth consecutive quarter as new capital committed to VC funds totalled only $297 million or 62 percent less than over the same period last year (Figure 1). At the end of the first half of 2013, domestic VC fundraising has reached $678 million, or less than half of $1.5 billion that was raised at the same time last year. Of the capital raised to date more than 53 percent has been by retail venture capital.

Figure 1: VC Investment by quarter, 2011 to 2013



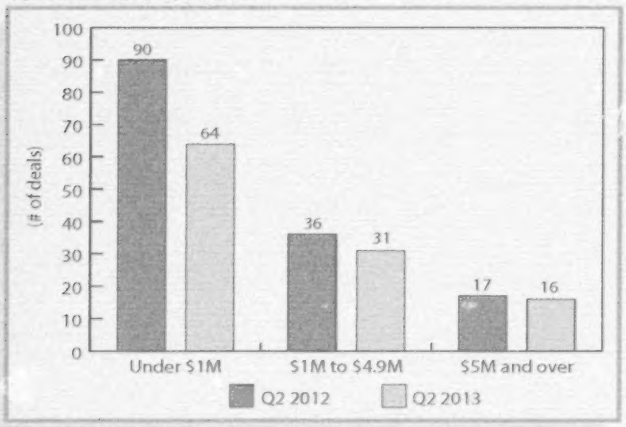
Source: Thomson Reuters Canada 2013.

Deal size

Average deal sizes up significantly during Q2 2013

Q2 2013 saw 32 fewer deals completed compared to the same period last year. Despite this, investment levels fell by only $15 million, the result of larger average deal sizes in Q2 2013. While the fall in completed deals was most pronounced in the under $1 million range there was also a slight decline in the number of deal in the $1 to $4.9 million range and in the greater than $5 million range (Figure 2). Larger than average deal sizes observed during the quarter stem from several major VC deals done between April and June, including the $50 million financing of Montréal-based clean-tech company Enerkem Inc.

Figure 2: Distribution of VC investment by deal size, Q2 2012 and Q2 2013



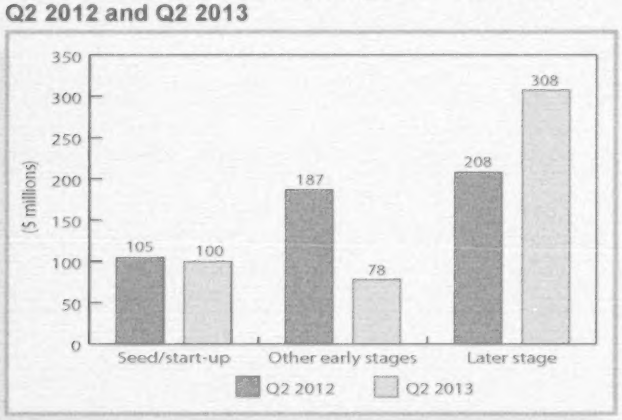
Source: Thomson Reuters Canada 2013.

Stage of development

Increased value of investment at later stages

Investments into seed and start-up stage companies remained relatively stable during Q2 2013 falling by only $5 million relative to Q2 2012 despite 8 fewer firms receiving financing (Figure 3). Firms at other early stages of development attracted $109 million less than over the same period, but this amount was largely made up by growth in investments at later stages of development which attracted $100 million more than over the same period the year before. As a result of these trends, investments into companies at later stages of development represent nearly 63 percent of all dollars placed into companies over the quarter.

Figure 3: VC investment by stage of development, Q2 2012 and Q2 2013



Source: Thomson Reuters Canada 2013.

New versus follow-on investments

Level of new, first-time investments fall over Q2 2013

Of the 112 deals completed over the quarter 49 were new, first-time investments into companies and 63 were follow-on investments (Table 2). The 49 new deals completed in Q2 2013 were worth $110 million with the majority of these deals occurring at the seed and start-up stages of firm development. In contrast to growth in new deals at the seed and later stages, other early stages of development saw a significant decline in investments as only three firms at this stage received financing in Q2 2013.

Table 2: Number of companies that received new versus follow-on investments, Q2 2012 to Q2 2013

Total Investment		Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013
New	Seed/ start-up	38	22	37	29	30
	Other early stages	19	4	11	20	3
	Later stage	11	8	7	12	16
	All	**68**	**34**	**55**	**61**	**49**
Follow-on	Seed/ start-up	18	8	12	9	18
	Other early stages	33	25	31	23	20
	Later stage	24	21	23	31	25
	All	**75**	**54**	**66**	**63**	**63**
Total		**143**	**88**	**121**	**124**	**112**

Source: Thomson Reuters Canada 2013.

Year-over-year follow-on investments fell by a small amount with 63 deals completed (worth $375 million) during the quarter compared to 75 during the same period the previous year. As expected, most follow-on activity took place at the later stages of development as these companies attracted a total of $245 million or 51 percent of all VC dollars invested during the quarter.

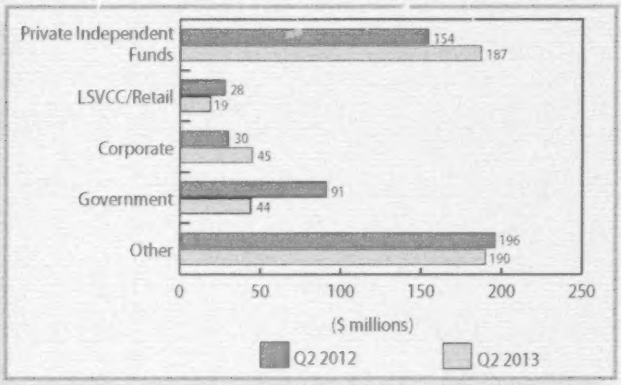
Type of investor

Increased investment among private independent VC funds

Private independent funds, corporate funds and other private sector funds (such as foundations and pension funds) accounted for a combined $380 million, or 78 percent of all dollars invested into the Canadian market (Figure 4). Of this amount $136 million came from Canadian-based sources, with the other $244 million

coming from foreign investors. The $244 million invested by foreign investors represented an increase of 64 percent from the $149 million they had invested over the same period during the previous year.

Figure 4: Distribution of VC investment by type of investor, Q2 2012 and Q2 2013



Source: Thomson Reuters Canada 2013.

The remaining investment $105 million invested into the market during Q2 2013 came from other Canadian sources. This includes $44 million from government sources, down from $91 million over Q2 2012. Investments from labour sponsored venture capital corporations (LSVCC) and retail funds experienced a similarly low quarter as these sources contributed only $19 million to the market over the quarter, continuing a trend of LSVCC investment over recent years.

Fundraising

Fourth consecutive quarter of declining VC fundraising

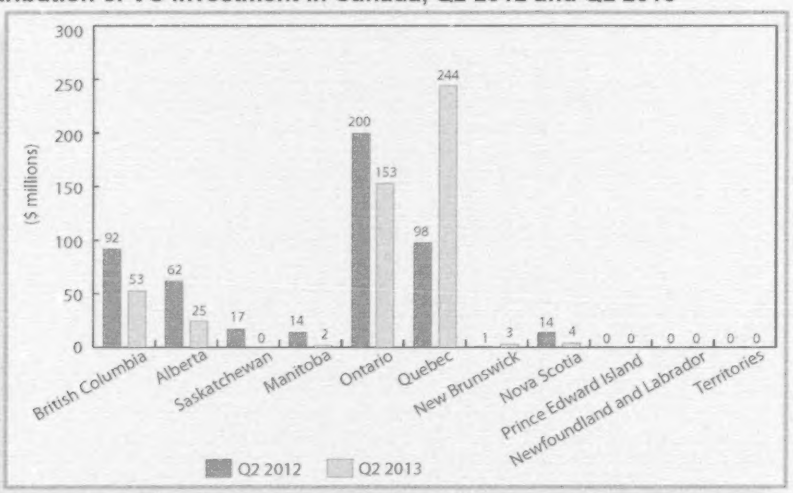
In contrast to investment levels Canadian VC fundraising activity fell for the fourth consecutive quarter as new capital committed to VC funds totalled only $297 million during Q2 2013 or 62 percent less than over the same period last year. Through the first half of 2013, domestic VC funds have brought in $678 million, less than half of the $1.5 billion that was raised at the same time last year. Of the capital raised to date in 2013 more than 53 percent has been by retail venture capital funds. It is anticipated that fundraising among private independent VC funds should increase once details of the federal government's Venture Capital Action Plan are announced in the upcoming months.

Regional distribution

More than half of all Canadian VC investments were made in Quebec during Q2 2013

For the second consecutive quarter, increased Canadian VC investment was heavily concentrated in Quebec. Quebec companies attracted $244 million over 53 deals during the quarter, more than doubling the $98 million invested into Quebec companies during Q2 2012 (Figure 5). This is the result of sizeable growth in average deal sizes, which grew by approximately two and a half times from $1.9 million in Q2 2012 to nearly $4.6 million during Q2 2013. As a result, Quebec companies attracted just over half of all VC dollars invested into Canadian companies during the quarter.

Figure 5: Regional distribution of VC investment in Canada, Q2 2012 and Q2 2013



Source: Thomson Reuters Canada 2013.

The other half of all Canadian VC dollars were mostly placed into Ontario and British Columbia firms, having attracted $153 million and $53 million respectively. This represented a slight decline in year-over-year investments in Ontario, falling to $153 million invested into 35 companies from the $200 million invested into 49 companies during the same period last year (Table 3). Virtually all provinces, with the exception of Quebec, had experienced a notable decline in investment levels with British Columbia, Alberta, Manitoba and Saskatchewan also experiencing sharp drops in investment dollars attracted over the course of Q2 2013.

Table 3: Number of companies receiving VC by province, Q2 2012 and Q2 2013

Province	Q2 2012	Q2 2013	Percent Change
British Columbia	17	11	-35
Alberta	5	7	40
Saskatchewan	4	0	-100
Manitoba	2	1	-50
Ontario	49	35	-29
Quebec	52	53	2
New Brunswick	3	3	0
Nova Scotia	10	2	n/a
Prince Edward Island	0	0	n/a
Newfoundland and Labrador	0	0	n/a
Territories	0	0	n/a

Source: Thomson Reuters Canada 2013.

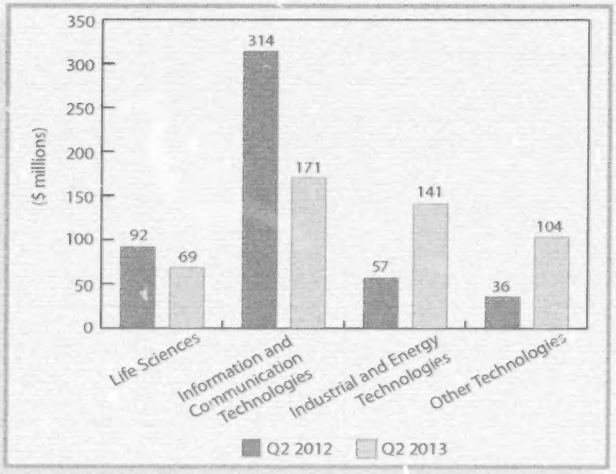
Sector distribution

Canadian VC growth largely concentrated in energy and environmental technologies during Q2 2013

Due to changes in how Thomson Reuters Canada reports its data, clean technology and alternative energy firms are now classified in the industrial and energy firms' category. Firms in this category worked to pace investment in the Canadian VC market during Q2 2013 as 27 firms absorbed close to $141 million (Figure 6). This represented one of the strongest quarters on record for the industrial and energy sector, which was largely buoyed by a new large financing round into Montréal's Enerkem Inc.

Investments into information and communication technology (ICT) firms fell substantially as $171 million was invested in the sector during Q2 2013, down from $314 million during Q2 2012. This is a lower amount than usually expected for ICT firms considering that these firms have generally represented around half of VC investments during any given quarter. However, growth in industrial and energy technology investments, as well as other VC investments, was enough to compensate for the ICT sector's shortfall over the quarter.

Figure 6: VC investment by industry sector, Q2 2012 and Q2 2013



Source: Thomson Reuters Canada 2013.

Government Activities

Business Development Bank of Canada Activities

The Business Development Bank of Canada (BDC) made VC commitments totalling $12.2 million into 19 companies over the course of Q2 2013 (Table 4). These financings were leveraged to a total of $14.4 million including contributions by co-investors. Additionally, the BDC invested a total of $5 million into private independent funds. Funds were matched by co-investors for a total of $5 million.

Table 4: VC activities of the Business Development Bank of Canada, Q2 2013

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed/start-up	6.4	7.9	14.3	14
Development	3.8	5.7	9.5	3
Later stage	2.0	0.8	2.8	2
Total	**12.2**	**14.4**	**26.6**	**19**

Source: Business Development Bank of Canada 2013.

Venture Capital Action Plan announcement

Following a comprehensive evaluation by the Venture Capital Action Plan (VCAP) expert panel, four high-performing venture capital funds have been selected to receive investments under the Venture Capital Action Plan. The announcement was made by the Honourable Jim Flaherty, the Minister of Finance, on September 20th with each recipient demonstrating strong investment performance aligned with the objectives of the Venture Capital Action Plan.

These investments are:

- a $15-million investment in Summerhill Ventures II, a fund focused on investment opportunities in the information and communication technologies sector;
- a $15-million investment in CTI Life Sciences Fund II, a fund focused on investment opportunities in the life sciences sector;
- a $10-million investment in Real Ventures Fund III, a fund focused on investment opportunities in the information and communication technologies sector; and
- a $10-million investment in Lumira Capital II, a fund focused on investment opportunities in the life sciences sector.

The Government of Canada's investment in the four high-performing venture capital funds is contingent on satisfactory negotiations with the selected fund managers. It is the latest step in the VCAP, a $400-million strategy launched in January to help increase private sector venture capital investments in order to create jobs, growth and long-term prosperity. The Government of Canada is continuing to advance other key components of the VCAP, including establishing four private sector-led large scale national funds of funds.

Launch of the Canadian Accelerators and Incubators Program

On September 23rd the National Research Council, through the Industrial Research Assistance Program (NRC-IRAP), issued a Request for Proposal under the Canada Accelerator and Incubator Program (CAIP) to solicit applications for funding support from leading business incubators and accelerators in Canada. CAIP represents a significant investment by the Government of Canada to support the growth and development of promising entrepreneurs and start-up firms.

Financial contributions will support new, incremental activities for outstanding and high-potential accelerators and incubators that promote: the development of investment-ready early-stage firms by accelerators and incubators; an increased range, availability and quality of services available to innovative early-stage firms, such as mentorship and business plan development; and stronger entrepreneur networks that link recipient organizations with other important innovation organizations in Canada and internationally.

Notes

This publication is part of a series prepared by the Small Business Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing.

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ISSN 1911-9267

Aussi offert en français sous le titre *Le Moniteur du capital de risque — Deuxième trimestre de 2013*.